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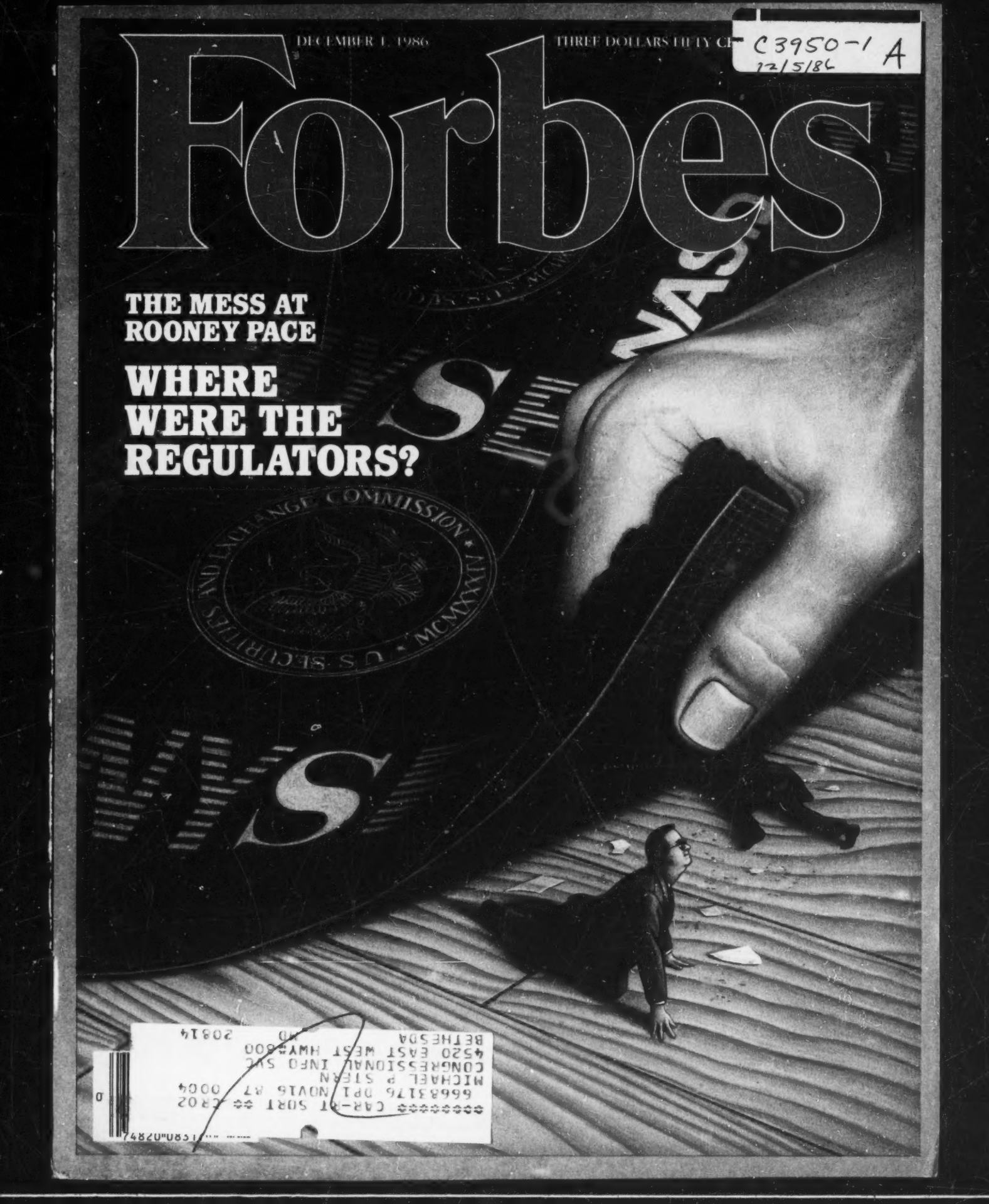
DECEMBER 1, 1986 THREE DOLLARS FIFTY CE

Forbes

THE MESS AT ROONEY PACE

WHERE WERE THE REGULATORS?



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Forbes

DECEMBER 1, 1986
VOLUME 138
NUMBER 12

43 *Texaco's James Kinnear*

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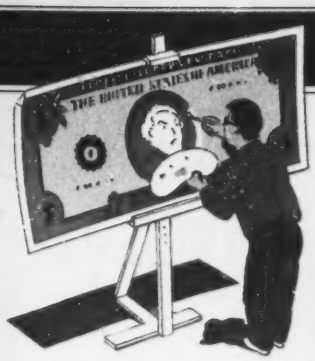

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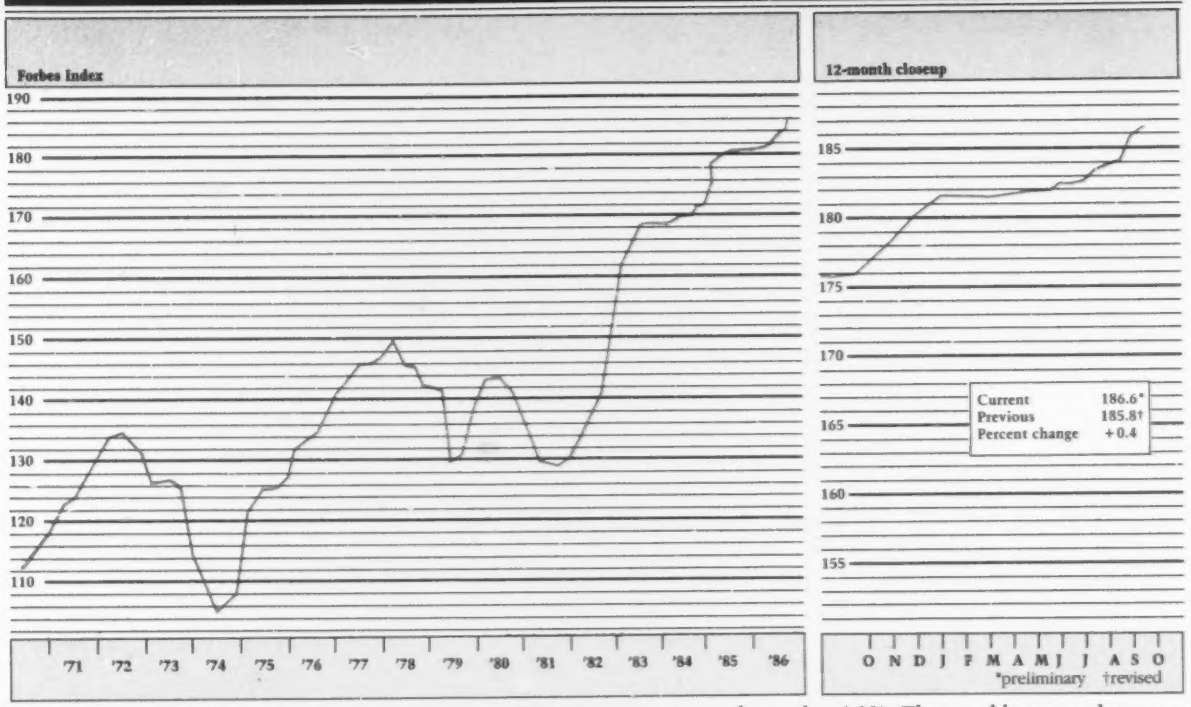
The Forbes Index

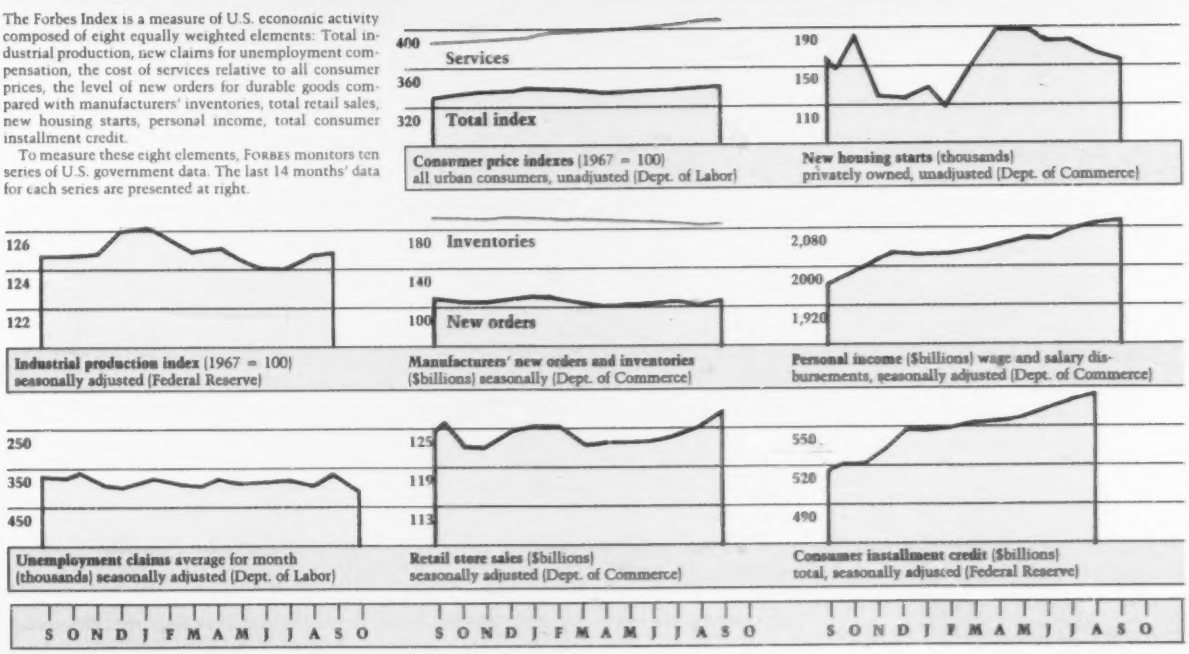


Will there be more jobs? The Forbes Index rose 0.4% in the latest reporting period. Manufacturers' new orders show a healthy 5% gain over the previous month, while inventories rose less than 0.1%. But new unemployment claims were up 12.9% from September to October. New jobs are being created only as fast as old ones are lost, but the work force rises. The overall unemployment level remains unchanged at 6.9%. That could worsen, however, by next year. General Motors recently announced plans to close nearly a dozen plants, and other closings are expected. Some of the employment slack in the manufacturing sector may be filled by Japanese-owned auto plants that will soon be operating in the U.S. But if the service sector can't fill the gap, unemployment levels will rise.

The Forbes Index Components

The Forbes Index is a measure of U.S. economic activity composed of eight equally weighted elements: Total industrial production, new claims for unemployment compensation, the cost of services relative to all consumer prices, the level of new orders for durable goods compared with manufacturers' inventories, total retail sales, new housing starts, personal income, total consumer installment credit.

To measure these eight elements, Forbes monitors ten series of U.S. government data. The last 14 months' data for each series are presented at right.


400
Services
360
320
Total index
190
150
110
Consumer price indexes (1967 = 100) all urban consumers, unadjusted (Dept. of Labor)
New housing starts (thousands) privately owned, unadjusted (Dept. of Commerce)
126
124
122
180
Inventories
140
100
New orders
2,080
2000
1,920
Industrial production index (1967 = 100) seasonally adjusted (Federal Reserve)
Manufacturers' new orders and inventories ($billions) seasonally (Dept. of Commerce)
Personal income ($billions) wage and salary disbursements, seasonally adjusted (Dept. of Commerce)
250
350
450
125
119
113
550
520
490
Unemployment claims average for month (thousands) seasonally adjusted (Dept. of Labor)
Retail store sales ($billions) seasonally adjusted (Dept. of Commerce)
Consumer installment credit ($billions) total, seasonally adjusted (Federal Reserve)
S O N D J F M A M J J A S O
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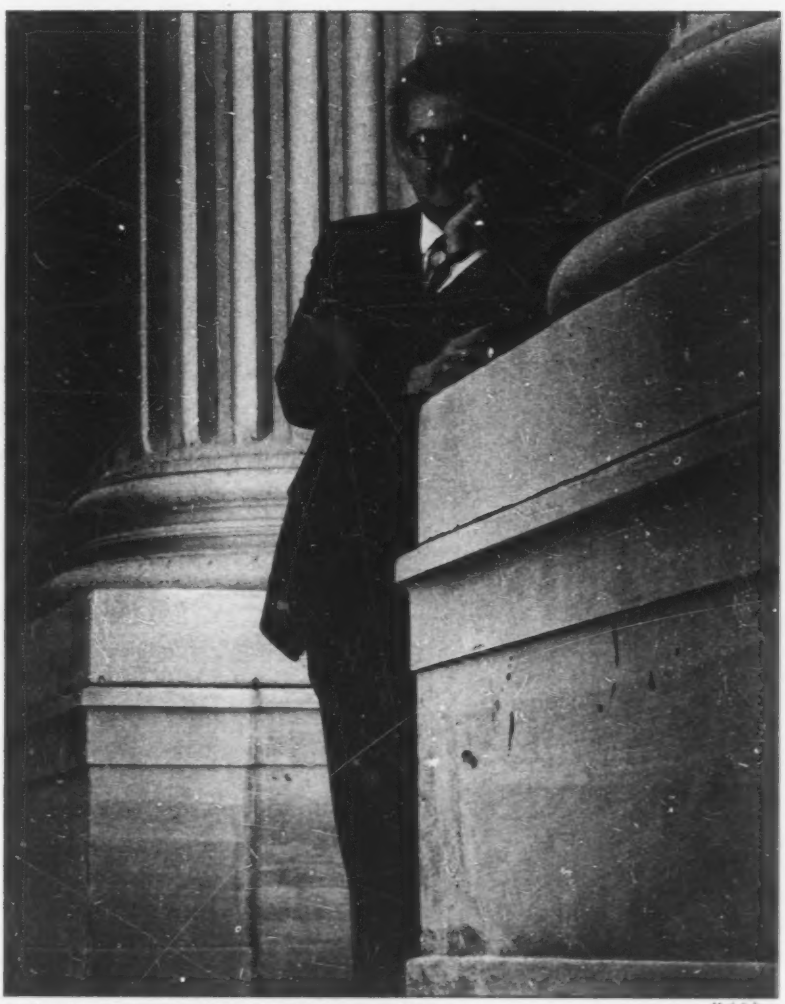
If President Reagan cuts a decent arms deal with Mikhail Gorbachev, it won't be because the Soviets have reformed but because they're worried and can no longer ignore their sickly economy.

The legacy of Stalin—

A chat with Seweryn Bialer



Mark Seliger

Columbia University Sovietologist Seweryn Bialer
"The Soviet system does not fit the third industrial revolution."

By Lawrence Minard and Peter Brimelow

THE RULERS of the Soviet Union genuinely want a halt in the arms race because they are impressed by U.S. technological advance and by the progress in rebuilding our military strength. The Soviets are today more nervous than ever at the prospect of falling hopelessly behind. So says Seweryn Bialer. Columbia University's renowned Sovietologist.

Raised in Berlin, Bialer, now 60, taught economics at the University of Warsaw until 1955, when he emigrated to the U.S. In his books, most recently *The Soviet Paradox: External Expansion, Internal Decline* (Knopf, $22.95), he writes with the knowledge of someone who has lived beneath the Communist yoke.

No, there are no fundamental changes currently under way in the Soviet Union. Says Bialer: "The mass terror is abolished. Personal dictatorship was abolished. But in the economic field, the Stalinist system is completely in command of Russia today."

By Stalinism, Bialer means centralization of power in Moscow, with scarcely any real decision making left to individuals anywhere in the vast country. Continuation of the system dooms the Soviets to backwardness but any real change threatens the power of the ruling elite. So clumsy is the system that even when its spies steal industrial secrets from the U.S., its industry cannot easily absorb what it steals.

"The Chinese adapt from America whatever they want and still think they're superior to us," says Bialer. "But the greatest thing with the Russian leaders, when they meet our leaders, is to say they should be equal with us because they have equal strategic power. But in all other aspects they are unequal. This makes them feel internally insecure, which was always the situation in Russia."

We ask Bialer: How do we know how weak the Soviet economy is? Can you get any kind of GNP numbers at all on the Soviet economy? "That is a wonderful question," says Bialer. "In my opinion, one can't. And I must tell you that most of the Soviet economists rely on the American calculations of the GNP made by the CIA that are presented every two years to the Congress in two green volumes."

Such is the secretiveness that grips the Soviet Union: Even its own economists must look outside for believable statistics.

"You have a situation," says Bialer, "where secrecy, underdevelopment of the infrastructure, the fear of risk, lack of entrepreneurship and lack of rewards all combine to make the Soviet Union—in the civilian sector, not the military sector—fall more and more behind the U.S. and other industrial countries."

Stalin's methods did work once. Look at any Soviet city: The major building seems to date from Stalin's time and just after. Even after Stalin's death in 1953 Khrushchev and then Brezhnev were able to claim that Russia could catch up with the West.

Today, however, the cheap resources have been depleted, the sheer energy that rebuilt the country has been dissipated. The Soviet economy is like a great beast that exhausted itself in a fight for survival and now sprawls, energyless and panting. To close the gap with the West, the Soviets must shift from extensive growth based on cheap natural resources and starvable human labor, to intensive growth based on microchips, information and human ingenuity—a shift, says Bialer, that has not been made and perhaps cannot be made.

Says Bialer: "There is no question that the Soviet system does not fit the third industrial revolution. Here, the Soviet system possesses all the characteristics that work against development. It is a secretive nation, where information is compartmentalized."

Centralization, repression—Stalinism—has enabled the leaders to mobilize enough resources to become a world military power. But down the Stalinist road lies economic stagnation. And with stagnation the struggle to retain military parity becomes harder and harder. With stagnation, too, the Soviet Union becomes a laughingstock, not the proud model for the future its founders dreamed about. The Soviet economy has become what a recent writer in *The American Spectator* aptly called "an overgrown Bulgaria."

"The elite look at the situation where, for the first time in Soviet history, the Soviet Union, far from closing the gap with the developed capitalist countries, is falling behind."

The problem is not essentially a military one. "People who know," says Bialer, "are telling me that with regard to airplanes and missiles, the Russians are four years behind [the West]. I think they are six years behind. Maybe they are eight years behind. But so what? The Russians are always behind, but they catch up—with enormous sacrifices—in the military field. It will cost them more. So what? They have a population that is ten times as hard in terms of sacrifices and is ten times more controlled by their government than America's."

But the sacrifices get harder and harder as the economy falls further and further behind. The ruling elite begins to suffer, not so much from fear of popular discontent but for reasons of security and prestige. The people may want consumer goods, but, says Bialer, "The elite think in different terms. Their standard of living is not stagnating. But they look at the situation where, for the first time in Soviet history, the Soviet Union, far from closing the gap with developed capitalist countries, is falling behind.

"The point is that the whole ideology and the whole sense of the Soviet Union as a global power is based on the assumption that this gap will be closing. And it is not. This is a major change. And a major crisis. And from this point of view, the reserves of growth that Gorbachev wants to ex-

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plest are totally insufficient."

Thus far Gorbachev has tinkered and temporized, hoping he can save the Stalinist system by squeezing more growth from it. Work harder, drink less. Don't steal state property for private use. There are new incentives for research institutes to be more productive. There is a crackdown on drinking—"this in itself is probably worth 1% of labor productivity increase a year," says Bialer, "if you knew how Soviet workers and engineers were drinking at work."

But nowhere has Gorbachev gone further than his predecessors. Says Bialer: "You know, every year since Stalin's death [in 1953] there have been dozens of reforms, which I compare to elections. They try to fight the worst irrationalities of the economic system. But they do not change the basic structural characteristics of the system, which I describe in my current book: centralized planning, centralized command, the stress on quantity as opposed to quality, the passive role of money and credit, profits being really an accounting device rather than a measurement of effectiveness."

Arthur Hartman, the U.S. ambassador to the Soviet Union, once observed to a FORBES reporter that whereas the West was going through a technological revolution based largely on the free flow of information, the Soviet system presumes that information should be kept under lock and key and doled out only to a few.

Bialer nods. "Information," he says, "is a part of power. A bureaucrat who has a particular knowledge of something will not part with this knowledge, because this knowledge is his leverage, his instrument of power.

"The photocopy machine, for example. You go to an institute of the Academy of Science and try to make a copy. Try to get a copy of anything. The machine is somewhere in a special room. Somebody is always there. You have to have a signature of somebody who is entitled to give a signature for making a copy. And you will wait quite a time until it is made.

"Let's take another example. Computers do not make sense unless connected with communications. All right, now look at the Moscow telephone net. Look how difficult it is to make a call. And this is in Moscow. Try to go to a small town and call up Moscow. You will wait two, three hours. Can you imagine those computers talking to each other in such a situation?

"Or take the question of software. I would be surprised if less than 80% of software in America comes from individual entrepreneurs and from small firms. In the Soviet Union—well, first of all, a man who would have the initiative to write a software program would have to have the computer. And there are no computers privately owned in the Soviet Union, not even word processors."

Don't Soviet managers ask for productivity-enhancing equipment, to help fulfill the ambitious planning targets set for them in Moscow? That, says Bialer, is to misunderstand entirely Soviet incentives.

"Suppose that you are the director of the factory of nails. Instead of producing your plan of 10,000 tons of nails, you produce 10,500 tons. Next year you will receive a new plan that will be based on your overfulfillment of the plan this year. You are punished because you have overperformed.

"Now, one must be an idiot, in this situation, to be interested in overfulfillment of the plan or new technology. If a first-rate American manager were transferred to Moscow, within two weeks he would figure out what is good for him and would act exactly as the Soviet managers are acting. It is not that they steal or are uneducated or untalented. They are simply working within a system that does not reward talent and innovation and technological progress."

Gorbachev is the latest of the problem, but to the Soviet economy. Gorbachev also all years rules the disintegration of the Soviet Soviet empire, which has been held together only by force and control and power. The Soviet Union is really a Russian empire ruling subject peoples. "A decentralization," explains Bialer, "would not be a devolution of power only among the Russians. It would be a devolution of power to ethnic groups, which compose 49% of the Soviet population, and this will encourage, if not an immediate, then at least centrifugal forces within the society."

Besides the empire, there are the tributary states in Eastern Europe. Recalling the direct link between Khrushchev's anti-Stalin speech to the Politburo in February 1956 and the Hungarian uprising later that year, Bialer asks: "If you have liberalization of the system in Russia, what conclusions will the people who want liberalization in Eastern Europe reach? They will make it to the nth degree."

So there you have it: Stalinist economics binds the empire together and keeps power firmly in the hands of the Communist aristocracy, but it breeds economic progress. Gorbachev has limited sympathy to the economists' plans to introduce market

An expensive place to live

Below are recent retail prices in Moscow for selected items, expressed both monetarily (at the official, though unrealistically high, rate of 1 ruble: $1.60) and in terms of the working time required to buy these items, using average industrial monthly take-home pay of $260 for Soviet workers, vs. $2,365 in the U.S. The numbers result from the invaluable work of Radio Liberty Research's Keith Bush, who warns of the many pitfalls inherent in such East-West comparisons. Among them: poor quality and availability of goods in Russia, where the consumer is a very low priority.

Consumer items	Rubles	Converted U.S. $	Work hours equivalent
white bread (2.2 lbs.)	1.32	2.08	49 minutes
frozen chicken (2.2 lbs.)	3.40	5.50	2 hours, 10 minutes
ice cream (2.2 lbs.)	1.92	3.08	1 hour, 10 minutes
butter (2.2 lbs.)	3.80	6.02	2 hours, 30 minutes
potatoes (2.2 lbs.)	0.20	0.30	12 minutes
tea (3.3 oz.)	3.76	1.12	46 minutes
red wine (1.1 qts.)	4.40	6.79	4 hours, 10 minutes
vodka (1 pt.)	5.40	8.60	5 hours, 15 minutes
small car (Zhiguli)	6,500.00	10,500.00	68.4 months
regular gasoline (2.4 gals.)	3.00	4.66	3 hours
beans	56.00	85.00	58 hours
man's shirt	13.00	20.77	13 hours
man's shoes	65.00	98.00	41 hours
color television (25 in.	700.00	675.75	169 hours
monthly rent subsidized, unfurnished)	10.00	20.00	12 hours, 30 minutes
VCR	1,200.00	1,775.20	1,200 hours

prices into the Soviet economy. In August Gorbachev fired the chairman of the State Committee for Prices, Nikolai Glushkov, for obstructing price reform.

Is this the beginning of real reform? Bialer: "Gorbachev is throwing out a minister. Whom is he appointing in his place? A vice minister. The vice minister is younger, more ambitious. But he has learned how to work from the minister. He's worked in the system. This is [Gorbachev's] major problem. It's not a problem that he cannot exchange people. It's a question for whom will he exchange them? He doesn't have the power to make the [really important] decisions. And he has still, in my opinion, illusions that lesser reforms can repair the system. In my opinion, they will improve, slightly, the economy's performance, but they will not repair its basic backwardness compared to us."

"The Soviets found that, despite strategic parity, we are on the verge of a new arms race where technology will play a higher role. Never in the past 20 years did they want arms control as badly as today."

Gorbachev, then, is not so much a dictator as he is a prisoner of the Stalinist system. And not only of the system but of Russian history as well. Says Bialer: "My proposition is that the autocratic, nondemocratic, centralized type of Soviet system did not go against the Russian tradition. Very simply, in the entire Russian history, from the beginning until today, there was not one day that they had a democratic regime. Not one day."

Hoping the system will magically rejuvenate but probably aware that it cannot, Gorbachev needs to deliver something. Freezing the arms race would take pressure off the economy, buy time for the system he represents. It would also enable the Red Army's generals to sleep more soundly. All of which means that an arms deal may be in the offing—one that the U.S. can accept. Says Bialer: "The Soviets have found out that, despite all their strategic parity with the U.S., we are on the verge of a new arms race where technology will play a higher role. Their [military] security will be in danger. Never in the past 20 years did they want arms control as badly as today." *(See story, p. 216.)*

A useful comment, that, for the critics of recent U.S. economic and military policy to remember. ■

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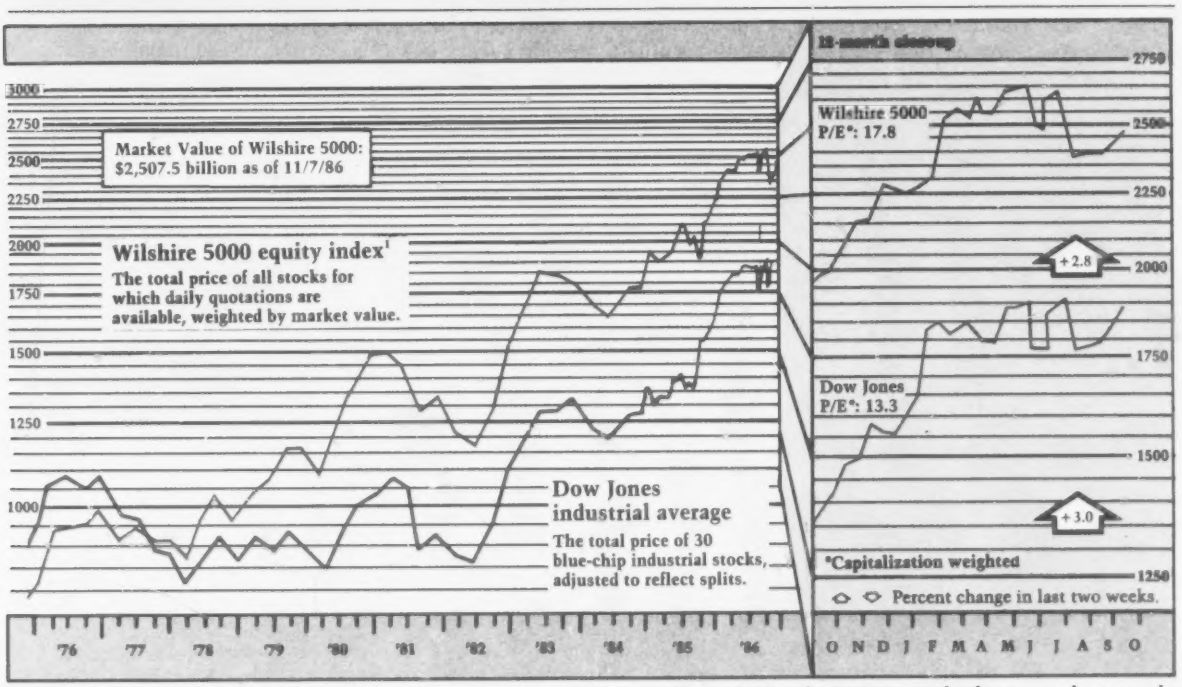

Market Value of Wilshire 5000: $2,507.5 billion as of 11/7/86
Wilshire 5000 equity index[1]
The total price of all stocks for which daily quotations are available, weighted by market value.
Dow Jones industrial average
The total price of 30 blue-chip industrial stocks, adjusted to reflect splits.
12-month closeup
Wilshire 5000 P/E*: 17.8
Dow Jones P/E*: 13.3
+2.8
+3.0
*Capitalization weighted
Percent change in last two weeks.
'76 '77 '78 '79 '80 '81 '82 '83 '84 '85 '86
O N D J F M A M J J A S O

The last correction is being corrected. It wasn't so long ago—Sept. 11—that the Dow fell 87 points. The causes of that fall—concerns about the economy, interest rates, the budget deficit and the trade deficit—have hardly been remedied. But passage of the tax bill and some respectable third-quarter earnings have evidently encouraged investors. The Wilshire index posted a 2.8% two-week advance. The Dow shows a two-week gain of 3%, a four-week gain of 5.2%. This brings the Dow within 33 points of its alltime high of 1919, a mark that may be tested within the coming weeks. On the other hand, secondary issues, particularly those traded on the Nasdaq, are further behind. Although the Nasdaq gained 1.2% over the last ten trading days, it still stands some 12.2% off its July high point.

Earnings multiples are again ratcheting upward. The Dow industrials now sell at 13.3 times latest 12-month earnings, while the P/E on the Wilshire 5000 index is 17.8.

Closeup On The Equity Markets

Performance of six leading indexes

Percent change	Wilshire 5000	Forbes 500[2]	Dow Jones industrials	NYSE Composite	Amex Market Value Index	NASDAQ Composite
in last 4 weeks	4.0	4.3	5.2	4.3	1.2	2.1
in last 52 weeks	25.0	21.8	34.3	26.4	14.5	20.3

Stock performance based on six key investor yardsticks

Percent change	Company size		Volatility[3]		P/E multiple		Dividend yield		Growth profile[4]		Share price	
	large	small	high	low	over 25	under 5	over 7.5%	none	high	low	over $40	under $4
in last 4 weeks	4.8	3.7	8.2	2.6	4.4	1.8	2.7	2.9	6.1	3.9	3.5	3.8
in last 52 weeks	29.8	43.1	63.9	31.0	21.9	32.9	25.0	40.0	53.0	38.4	35.8	27.7

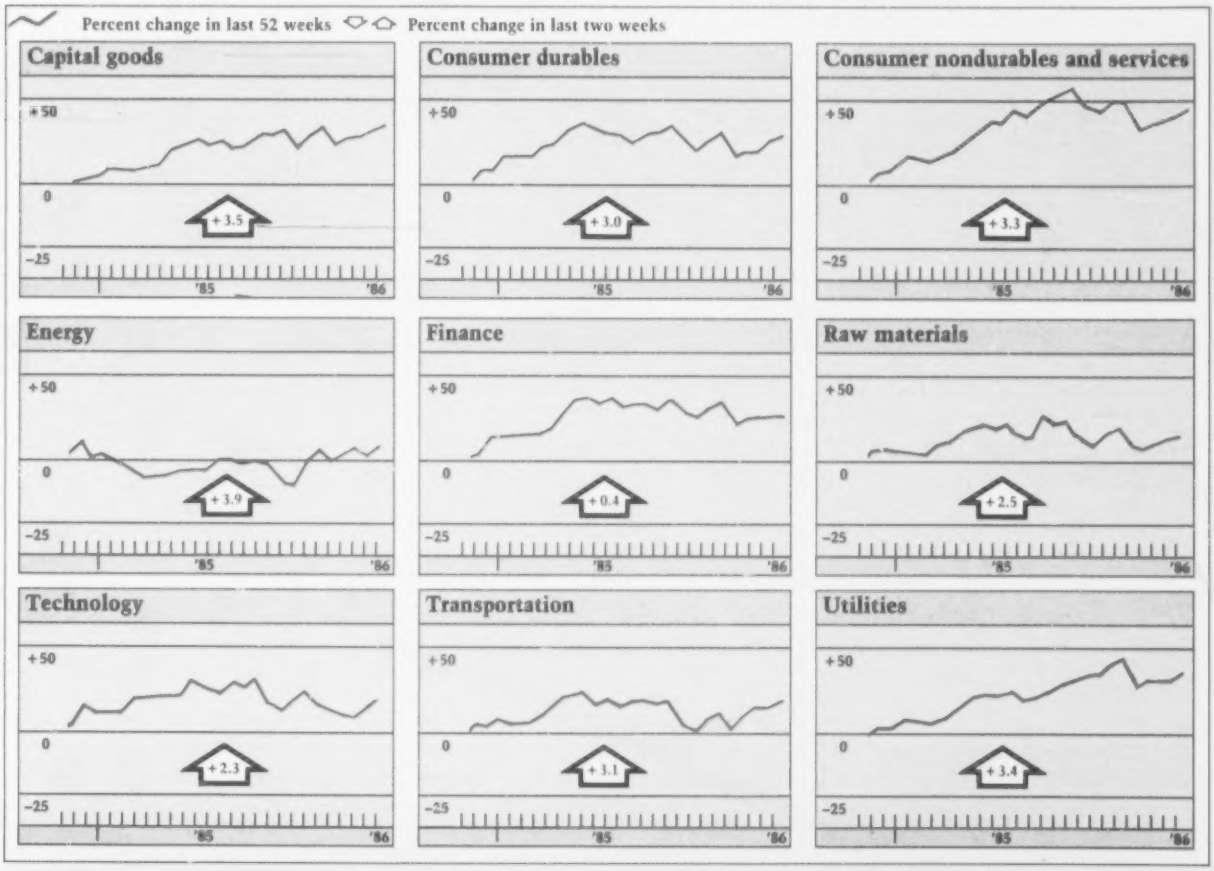
[1]Wilshire index reflects price performance. It differs slightly from market value of outstanding stocks because of retirements of equity since index was created. [2]Based on sales. [3]A stock's sensitivity to overall market movement. High-volatility issues have wide price fluctuations, low-volatility issues are more stable. [4]A quantitative evaluation of a stock's growth image, determined by Wilshire Associates.

Note: All data for periods ending 11/7/86. Prepared by Wilshire Associates, Santa Monica, Calif.

Where The Action Is

Takeovers and restructurings helped five big consumer stocks in the last two weeks. Gillette led with a 33% gain. There is speculation that either Unilever or Ronald Perelman's Revlon Group will make an offer for it. Winn-Dixie Stores rose 29% on takeover rumors, made plausible by Asher Edelman's recent run at Lucky Stores. Zayre is up 29% because of a stock buyback plan. Nursing home operator Beverley Enterprises gained 28% on its late-October plan for a leveraged buyout. Zale, with a 26% gain, is being courted by Peoples Jewellers of Canada.

Finance stocks, with a 0.4% gain, underperformed the market. Hardest hit were insurance stocks: Alexander & Alexander, a brokerage and agency firm, fell 19%. Marsh & McLennan, the largest such concern, lost 10%.



What The Analysts Think

Ford's and Chrysler's 1986 earnings forecasts were raised during the last two weeks. The gains were small—2.5% for Ford and 3.6% for Chrysler—but they helped raise the capitalization-weighted forecast for consumer durables by 0.3%. Among other estimated increases were Black & Decker, up 8.9%, and Chicago Milwaukee, up 10.8%.

Forecasting the Forbes 500

Performance period	Average earnings per share	P/E
latest 12 months	$2.72	16.2
1986 estimates	3.18	13.9
1987 estimates	3.82	11.6

Rank based on change in estimate	Sector	Estimated 1986 EPS	Estimated 1986 P/E	% change in 1986 estimate in 2 weeks	% change in 1986 estimate in 4 weeks
1	Consumer durables	$3.79	11.0	0.25%	-0.58%
2	Utilities	3.28	10.7	0.04	0.12
3	Consumer nondurables	2.10	17.0	-0.49	-0.96
4	Transportation	1.40	22.4	-0.67	-7.20
5	Energy	2.18	16.1	-0.92	-1.91
6	Finance	3.15	11.1	-0.98	-1.61
7	Raw materials	1.81	18.3	-1.10	-2.21
8	Capital goods	2.25	16.7	-1.30	-1.07
9	Technology	2.46	15.2	-2.63	-4.93

Earnings projections are capitalization-weighted consensus estimates from over 2,000 security analysts. Data are compiled and updated continuously by the Institutional Brokers Estimate System (IBES), a service of Lynch, Jones & Ryan, a New York-based brokerage firm.

Note: All data for periods ending 11/7/86. Prepared by Wilshire Associates, Santa Monica, Calif.; IBES, a service of Lynch, Jones & Ryan, New York.

Statistical Spotlight

Analysts were far too optimistic last year with earnings forecasts. So did the market collapse this year? No, it went up.

Right for the wrong reasons

By Michael Ozanian

THE GOOD NEWS was that the Dow went way up. The bad news, for people who take Wall Street analysis seriously, is that the move was completely independent of earnings forecasts.

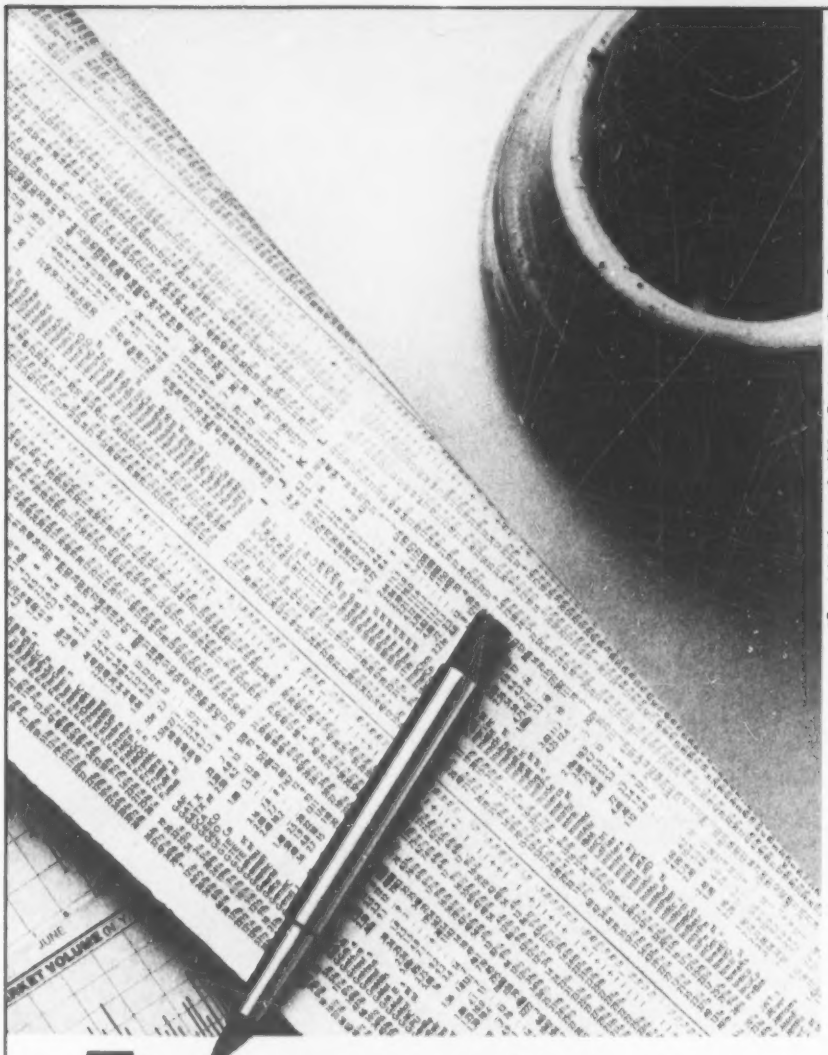
A year ago market watchers were talking about a 1900 Dow within 18 months (FORBES, *Nov. 4, 1985*). The scientific basis for this wild forecast, at a time when the Dow was a mere 1327, was earnings estimates. For those we turned to compilations by the Institutional Brokers Estimate System (IBES), which tracks the work of over 2,500 Wall Street analysts. The consensus was for the 30 Dow stocks to earn $133 in 1985 and $162

Another try at the Dow 30

Company	Earnings estimates 1986 (old)	1986 (current)	1987 (current)	Recent price	52-week high–low	1987 est P/E
Allied-Signal	$4.92	$3.66	$4.22	41⅜	49½ – 36¼	9.8
Aluminum Co of Amer	3.53	2.12	3.88	37⅛	46⅛ – 32⅛	9.6
American Can	5.96	6.16	6.88	88½	91⅞ – 58½	12.9
American Express	4.53	4.95	5.57	59½	70⅛ – 48⅞	10.6
American Tel & Tel	2.01	1.73	1.99	24⅞	26 – 20⅛	12.5
Bethlehem Steel	2.20	–2.89	1.32	7	22 – 6¼	5.3
Chevron	4.86	3.00	3.14	43½	47⅛ – 33⅝	13.9
El du Pont de Nemours	6.18	6.44	7.09	86⅛	89 – 59½	12.2
Eastman Kodak	4.26	2.77	4.27	64	64⅜ – 43¼	15.0
Exxon	7.14	6.42	6.08	69⅜	71⅛ – 48⅜	11.4
General Electric	5.83	5.46	5.19	77⅜	82⅛ – 59⅜	14.9
General Motors	11.73	9.37	8.79	72⅛	78⅜ – 46⅞	8.2
Goodyear	3.73	2.90	3.26	48⅛	50 – 36⅛	14.8
Inco Ltd	1.35	0.01	0.63	12⅜	18⅞ – 10⅛	19.4
IBM	12.85	9.68	11.24	126⅛	161⅞ – 112⅜	11.2
Intl Paper	4.07	3.94	5.17	73½	73½ – 45⅛	14.2
McDonald's	3.83	3.76	4.33	63⅛	76¾ – 45⅜	14.6
Merck & Co	4.25	4.73	5.62	110	116¾ – 58½	19.6
Minnesota Mng & Mfg	7.02	6.77	7.65	109	116 – 78⅛	14.2
Navistar Intl	1.71	0.37	0.90	6	11⅜ – 5¾	6.7
Owens-Illinois	2.97	3.06	3.48	42⅛	45⅜ – 28	12.1
Philip Morris Cos	5.98	6.18	7.60	73	78 – 36⅛	9.7
Procter & Gamble	4.68	4.30*	4.76	76⅞	87½ – 60⅜	16.1
Sears, Roebuck	4.52	3.89	4.51	63⅜	80½ – 34¼	9.7
Texaco	4.75	3.19	3.05	35⅛	39⅝ – 26	11.5
Union Carbide	2.09	1.42	2.09	22	25½ – 18¾	10.5
United Technologies	5.07	3.85	4.87	42⅞	56¼ – 39⅛	8.8
USX	5.37	–1.90	1.16	25¼	28¾ – 14½	21.8
Westinghouse Elec	4.03	4.36	5.05	57⅞	60¼ – 25	11.5
FW Woolworth	2.80	3.21	3.69	44½	49 – 25¼	12.1

*Actual. Note: Dow Jones index is based on the sum of 30 company figures divided by 0.889.

Sources: The Institutional Brokers Estimate System (IBES), a service of Lynch, Jones & Ryan, via Micro/Scan Data on diskette from Isys Corp.; FORBES.



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These companies earned an unexpected dividend this quarter.

They invested in the arts and it's paid off handsomely.

Only this time the return is in the form of national recognition. A distinguished panel of judges has just declared them winners in the 1986 Business in the Arts Awards competition. The Awards, cosponsored by the Business Committee for the Arts and Forbes Magazine, is the first and only national awards program to honor business for its outstanding arts partnerships.

The competition involved more than big blue-chip companies. Winning firms ranged in size from small local businesses to giant multinational corporations, from New Hampshire to California. Their involvement took many forms – a cash grant, the loan of personnel, the provision of in-kind goods or services, or a tie-in that used the arts in advertising or promotion.

Congratulations to the 1986 Business in the Arts Awards winners. Showing an interest in the arts now could earn your company plenty of interest when next year's winners are selected.

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First National Bank of Louisville
Louisville, Kentucky

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